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C O N F I D E N T I A L SECTION 01 OF 03 ASHGABAT 001235

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STATE FOR SCA/CEN, EEB
PLEASE PASS TO USTDA DAN STEIN
ENERGY FOR EKIMOFF
COMMERCE FOR HUEPER

E.O. 12958: DECL: 11/13/2017
TAGS: PREL PGOV EPET ECON TX
SUBJECT: TURKMENISTAN: RESOURCE NATIONALISM EXISTS, BUT MANAGEABLE FOR NOW

REF: A. SECSTATE 150999
¶B. ASHGABAT 1209
¶C. ASHGABAT 1104
¶D. ASHGABAT 1067
¶E. ASHGABAT 1066

Classified By: Charge Richard E. Hoagland for reasons 1.4(B) and (D).

¶1. (C) SUMMARY: Although the Government of Turkmenistan up to now has pursued a policy of resource nationalism by banning foreign companies from its gas fields in the East (foreign companies are working the Caspian oilfields), Turkmenistan may be reconsidering this policy. At the heart of this new thinking is a need to increase production in order to fund the new president's ambitious program of public construction, rural development and healthcare and education reform. While Turkmenistan continues to have world-class hydrocarbon reserves, its infrastructure has been deteriorating for years, and the easy-to-reach gas fields are playing out. Turkmenistan's state-owned hydrocarbon firms do not have the expertise, technology or resources needed to maintain production at current levels, far less to increase the country's production to meet Turkmenistan's growing number of export commitments. Post understands that Turkmenistan is considering signing a joint venture agreement with Chevron that would allow the company virtually unprecedented (for foreign firms) access to the Amu Darya basin. Providing officials with the knowledge and information they need to make informed decisions could help increase their confidence in dealing with the West in general, and with Western firms in particular. END SUMMARY.

¶2. (SBU) A hydrocarbon-rich state that shares borders with Afghanistan and Iran, Turkmenistan is in the midst of an historic political transition. The unexpected death of President Niyazov on December 21, 2006, ended the authoritarian, one-man dictatorship that by the end of his life had made Turkmenistan's government among the most repressive in the world. Following Niyazov's death,

President Gurbanguly Berdimuhamedov quickly assumed power with the assistance of the "power ministries" -- including the Ministries of National Security and Defense, and the Presidential Guard. Berdimuhamedov inherited a country that former President Niyazov had come close to running into the ground. Niyazov siphoned off much of Turkmenistan's hydrocarbon proceeds into non-transparent slush funds used, in part, to finance his massive construction program in Ashgabat. Although Turkmenistan only has a population of about 5 million, its economy is predominantly gas-based, and the state sector accounts for more than 75% of its economic activity.

¶3. (SBU) Western analysts believe that Turkmenistan's official estimate of its gas reserves -- 75 trillion cubic meters -- is exaggerated, but there is no disagreement that Turkmenistan has world-class natural gas reserves and smaller, but still significant, oil reserves. The bulk of its gas is located in the Amu Darya basin, in the country's east, while most oil is located in the Caspian basin to the west.

INCREASING EXPORT COMMITMENTS MANDATE INCREASED PRODUCTION

¶4. (SBU) Niyazov inherited a pipeline structure in which all of Turkmenistan's oil and gas pipelines ran northward, to Russia. Under Niyazov, Turkmenistan maintained its Russia-centric export focus, and it did so with a quirky policy of selling hydrocarbons at the border. In the 15 years following Turkmenistan's independence, the government flirted with the idea of creating alternate export pipelines, including through Afghanistan to South Asia, to Iran, and



across the Caspian to Azerbaijan. Except for a small pipeline to Iran (with a maximum capacity of 13-14 bcm per year), none these plans came to fruition, leaving Turkmenistan overly dependent on its exports to Russia. As a result, Turkmenistan for years received only $40 per thousand cubic meters (tcm) from Gazprom, even as Gazprom was charging European countries $253 per tcm for gas. Given Niyazov's massive depredations on Turkmenistan's hydrocarbon revenue, little money was left over for in-country infrastructure renovation and development. Although Niyazov in September 2006 successfully forced Gazprom to increase its payments to $100 per tcm, Berdimuhamedov is also relying on both that increased hydrocarbon revenue and planned production/export increases to fund his on-going construction program, rural development and ambitious improvements to the healthcare and education sectors.

¶5. (SBU) With those needs in mind and recognizing as well that pipeline diversification strengthens Turkmenistan's sovereignty, Berdimuhamedov is actively seeking to expand Turkmenistan's export commitments. In July 2007, he signed an agreement with China to export 30 bcm of gas per year for the next 30 years after a new pipeline to China is completed in 2009. Berdimuhamedov has also publically raised the possibility of resurrecting plans for Trans-Caspian and Trans-Afghanistan pipelines that would avoid the Russian routes, but he also took the first steps needed to increase the volume of gas exports to Russia -- agreeing in principle to refurbish the Caspian littoral pipeline -- during a May tripartite summit in Turkmenbashy. The result: Turkmenistan's production now must not only continue to meet existing commitments of approximately 75 bcms (i.e., 50 bcms to Russia, 8 bcms to Iran, and approximately 17 bcms for domestic consumption), but must grow to make possible these increased exports.

CRUMBLING INFRASTRUCTURE AND DECLINING GAS PRODUCTION PROMOTE NEW THINKING

¶6. (C) In the gas regions, the focus, including during the Soviet era, has been on extracting oil in already-explored large fields known to be gas-rich, such as Dovletabad. Up to

now, the Government of Turkmenistan has sought to work its gas reserves through its own government-owned company, Turkmengaz. When necessary, this company has contracted with U.S. or other western firms, but only through service contracts with limited terms and scope. While Turkmenistan agreed shortly after Turkmenistan's independence in 1991 to allow the Argentinian company, Bridas, to work a gas field in what is now Yoloton under a joint venture -- under terms highly advantageous to Bridas -- this deal fell apart a few years later when Niyazov demanded to renegotiate the PSA and Bridas refused, leading to government confiscation of Bridas' property in Turkmenistan and an acrimonious, drawn-out (and still unresolved) international arbitration process that Turkmenistani officials continue to cite as the rationale for not allowing foreign companies access to the gas fields.

¶7. (C) However, the years of minimal government investment into renovating and upgrading Turkmenistan's crumbling hydrocarbon infrastructure have led to a gradual decline in production. Moreover, most of the reserves in the Cretaceous layer in these existing fields -- the gas that has been easiest to extract -- are beginning to play out. Although western analysts believe that there remain extensive reserves in the Jurassic layer and in previously unexplored fields, most also state that the challenges of working these new reserves are beyond the capabilities of Turkmenistan's expertise, technology and resources: a thick salt sheet separates the Cretaceous and Jurassic layers, and much of the Jurassic-layer gas has a high sulphur content. These factors



reportedly are leading Turkmenistan's hydrocarbon officials to reconsider the previous ban on allowing foreigners to lease on-shore fields. Turkmenistan already has signed a production sharing agreement (PSA) allowing the China National Petroleum Corporation to work an area on the right bank of the Amu Darya river. Officials reportedly are also considering allowing Chevron to sign a joint venture contract that would, for the first time in years, offer a western company the opportunity to develop on-shore gas fields in the Amu Darya basin (refs b, c, e). Post's understanding of the proposed deal is that it is Chevron's experience, demonstrated technical expertise and willingness to consider non-traditional and innovative contact arrangements that address the Government of Turkmenistan's reluctance to allow western firms a foothold in its onshore gas fields that is leading the government to reconsider its policy. If Turkmenistan allows foreign firms into the Amu Darya basin, the policy of selling gas at the border -- the government's solution for minimizing foreign influence in the gas fields -- could also eventually change.

FOREIGN COMPANIES IN OILFIELDS UNDER PRESSURE TO CHANGE PSA TERMS

¶8. (C) By contrast, the Government of Turkmenistan has been more willing to allow foreign companies (Dragon Oil, Mitro, Petronas, Wintershall and Burren Resources) to work its oil fields in western Turkmenistan and the Caspian Sea. Whereas the government at first may have needed these firms' technical expertise and resources to work the oil, the foreign firms, operating under agreements based on the model PSA contained in the 1997 Petroleum Law, have become much more efficient at working oil than Turkmenneft, Turkmenistan's clunky state-owned oil company. (One expert recently estimated that it takes Turkmenneft 18 months to do what it takes the foreign companies, collectively, six months to do.) Most of these firms have profited under the terms of their PSAs, and Turkmenistan for some time has been relying on the overseas sales of petroleum products produced from these companies' oil to help fund Turkmenistan's activities in the gas sector. Recently post has heard rumors from these companies that the government has been seeking to change the terms of their PSAs, including to change the oil-sharing percentages. Although these companies reportedly have succeeded in persuading the government not to renegotiate

their existing PSAs, it seems likely that companies now negotiating future PSAs for offshore blocks -- reportedly including ConocoPhillips/Lukoil, Chevron and BP/TNK-BP -- may need to accept new requirements that the government sees as being more beneficial to itself.

COMMENT

¶9. (C) While Turkmenistan undoubtedly would prefer to follow a policy of resource nationalism, officials seem to be realizing that their current hand does not allow them such an option. As Turkmenistan considers the benefits of greater direct engagement with Western companies, however, it feels it stands at a disadvantage, due to its officials' inexperience in dealing with the West in general, and Western firms in particular. The U.S. government can help to ameliorate these concerns by providing training and information directed toward providing Turkmenistan's officials' with the knowledge and information they need to make informed decisions -- and to become more confident in working with Western firms. END COMMENT.
HOAGLAND